Economic Outlook

B4750-2

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

March 1986

It's hard to imagine a more favorable combination of events for the stock market: a precipitous decline in oil prices, a major bond market rally, and sharp depreciation of the dollar. These developments bode well for the overall economy also. The depreciation of the dollar has improved the growth prospects for numerous industries, while declines in interest rates are supportive of continued economic expansion. In addition, with the notable exception of the auto industry, inventories have generally moved into a comfortable position relative to sales. As a result, real GNP is expected to rise 4.1% from the fourth quarter of 1985 to the fourth quarter of 1986, compared to a 2.3% rise during 1985. The monthly data reported so far this year, however, have been listless.

The economy is poised for an improvement in growth, but it is not yet evident in the monthly numbers. Industrial production fell a sharp 0.6% in February (on a month-to-month basis) after rising only 0.1% in January. Retail sales fell 0.1% in February and 0.2% in January. Auto sales have weakened in March and will likely remain sluggish until the current program of incentive financing is made more attractive. In past periods, a sharp rise in the stock market was usually followed by a pickup in consumer spending. The effects so far are not visible, but the bull market is bound to give a significant boost to consumer spending.

One area of potential weakness in the economic outlook is business capital spending. Nondefense capital goods orders rose only 0.7% last year and fell sharply in January. The pattern among various types of capital goods is uneven. Orders have risen sharply for communication equipment and for aircraft but have fallen for most other types of equipment. The depreciation of the dollar will help domestic capital goods producers as well as their customers, but last year's sluggish economy has still been an important influence in this year's capital spending budgets.

A recent McGraw-Hill survey projects only a 3.4% rise in plant and equipment spending this year. Although this is an improvement from the 1% decline indicated in its survey taken last fall, and although capital spending budgets may well be revised upward during the course of the year, capital spending does seem to be a vulnerable spot in the overall economic outlook. In addition, the proposed elimination of the investment tax credit would remove an important investment incentive. The oil service and equipment industry will be hit particularly hard as oil companies cut their capital and exploration spending in face of lower oil prices. In 1985, the petroleum industry accounted for an estimated 6.9% of all plant and equipment expenditures in the United States and 17.4% of investment by manufacturing companies.

The rally in the bond market is likely to prove a powerful stimulus to the housing industry. Conventional 30-year mortgage rates of 9.5%-9.75% are already being offered in some parts of the country. We have revised our forecast of housing starts upward to 1.8 million units this year, compared to 1.73 million units in 1985. The level would be even higher if not for overbuilding in some parts of the country. The resale market is likely to be especially active as homeowners attempt to get out of the high-rate mortgages of 1980-1984 and take advantage of today's lower rates.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual 1985 I	II	III	IV	Forecast 1986 I	II	III	IV	Actual 1983-1984	1984-1985	Forecast 1985-1986
Gross National Product	6.9	4.3	3.8	4.5	7.2	7.1	8.0	8.2	11.0	5.7	6.5
Real GNP	3.7	1.5	3.0	1.2	4.2	4.8	3.8	3.3	6.6	2.3	3.3
GNP Price Deflator	3.1	2.7	2.7	3.3	2.8	2.2	4.0	4.7	4.0	3.1	3.1

	Actual 1985:IV	Forecast 1986:I	Actual 1983-1984	Actual 1984-1985	Forecast 1985-1986
Consumer Spending	4.1%	5.6%	6.7%	6.6%	5.6%
Durable Goods	-0.8	15.0	14.3	9.1	6.0
Nondurable Goods	0.6	3.0	6.8	4.6	3.7
Services	5.7	6.2	6.0	7.3	6.9
Business Capital Spending	10.2	6.8	20.1	11.2	6.1
Structures	1.6	4.4	17.0	13.4	5.9
Equipment	14.4	7.0	21.2	9.9	6.2
Residential Investment	10.5	12.6	17.8	5.6	11.7

	1984	1985	1986
Change in Inventories	$-25.0b.	$67.1b.	$17.5b.
Net Exports of Goods and Services	$-106.3b.	$-98.2b.	$-89.0b.

	1983-1984	1984-1985	1985-1986
Government Purchases	9.0%	10.7%	8.0%
Federal	8.3	13.5	9.0
Defense	9.8	10.3	7.5
Other	5.9	22.4	13.1
State & Local	9.6	8.5	7.3
Corporate Profits Before Tax	19.8	-6.0	9.1
Corporate Profits After Tax	19.0	-4.4	9.0
Plant and Equipment Expenditures	14.3	8.4	3.8
Real Final Sales*	6.3	3.0	3.2
Real Disposable Personal Income	4.1	1.6	2.4

Economic Indicators	Dec.	Jan.	Recent Data Feb.	Actual 1983-1984	1984-1985	Forecast 1985-1986
Consumer Price Index**	4.6%	3.6%	N.A.	4.3%	3.8%	3.5%
Producer Price Index for Finished Goods**	0.3	-0.4	-0.2	1.7	1.8	0.9
Industrial Production	0.8	0.1	-0.1	6.5	2.2	3.2
Retail Sales**	1.9	-0.2	-0.1	10.4	6.3	4.7

	1984	1985	1986
Auto Sales (millions of units, a.r.)	11.3	10.7	10.7
Housing Starts (millions of units, a.r.)	1.76	1.73	1.80
Unemployment Rate	7.5%	7.2%	6.6%
Merchandise Trade Deficit (a.r.)	$[78.4b., $101.6b.	N.A.	$123.2b.	$144.6b.	$155.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

*GNP less change in inventories, both in real terms.
**Monthly percent changes are not annualized.

*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

March 14, 1986

$b. = billions a.r. = annual rate F = Forecast